

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Unit Name		County
Fiscal Year End	Opinion Date		Date Audit Report Submitted to State	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

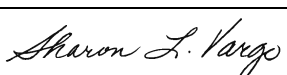
YES
NO

Check each applicable box below. (See instructions for further detail.)

1. ☐ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☐ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☐ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☐ ☐ The local unit has adopted a budget for all required funds.
5. ☐ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☐ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☐ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☐ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☐ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☐ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☐ ☐ The local unit is free of repeated comments from previous years.
12. ☐ ☐ The audit opinion is UNQUALIFIED.
13. ☐ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☐ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☐ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)		
Financial Statements	<input type="checkbox"/>			
The letter of Comments and Recommendations	<input type="checkbox"/>			
Other (Describe)	<input type="checkbox"/>			
Certified Public Accountant (Firm Name)		Telephone Number		
Street Address		City	State	Zip
Authorizing CPA Signature 	Printed Name		License Number	

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

**Financial Report
with Supplemental Information
June 30, 2006**

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

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Plante & Moran, PLLC
Suite 120
511 Renaissance Drive
St. Joseph, MI 49085
Tel: 269.982.8000
Fax: 269.982.2800
plantemoran.com

Independent Auditor's Report

To the Joint Board of Commissioners
Benton Harbor - St. Joseph
Joint Wastewater Treatment Plant

We have audited the accompanying basic financial statements of Benton Harbor - St. Joseph Joint Wastewater Treatment Plant as of June 30, 2006 and 2005 and for the years then ended. These financial statements are the responsibility of the Joint Plant's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Benton Harbor - St. Joseph Joint Wastewater Treatment Plant at June 30, 2006 and 2005 and the changes in financial position, including cash flows, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis is presented for the purpose of additional analysis and is not a required part of the basic financial statements of Benton Harbor - St. Joseph Joint Wastewater Treatment Plant. We did not examine this data and, accordingly, do not express an opinion thereon.

Our audits were conducted for the purpose of forming an opinion on the Joint Plant's basic financial statements. The accompanying other supplemental information, as identified in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The other supplemental information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Plante & Moran, PLLC

August 1, 2006

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Management's Discussion and Analysis

About the Facility

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant (the "Joint Plant") serves the Benton Harbor - St. Joseph regional area with wastewater treatment services. The facility is owned by the cities of Benton Harbor and St. Joseph, as tenants in common. Control, management, and operation of the Joint Plant are vested in the Joint Board of Commissioners (the "Joint Board"). The Joint Board consists of eight members, with three representatives each from the cities of Benton Harbor and St. Joseph and one member each from Benton Charter Township and the Lake Michigan Shoreline Water and Sewage Treatment Authority. Act 129 of Michigan Public Acts of 1943 is the enabling state legislation authorizing the cities of Benton Harbor and St. Joseph to establish the Joint Board. The Joint Plant is a corporate body under Act 129. Act 129 charges the Joint Board with establishing treatment service rates adequate to pay bonded indebtedness and operating costs.

The Joint Plant provides wastewater treatment services to the owner cities of Benton Harbor and St. Joseph, the townships of Benton, St. Joseph, Lincoln, and Royalton, and the villages of Shoreham and Stevensville. The connected service population is approximately 57,140. Treatment capacity of the facility is 15.3 million gallons per day. For the fiscal year ended June 30, 2006, the Joint Plant treated an average flow of 8.1 million gallons per day.

Mission Statement and Sources of Revenue

The Joint Plant's mission is to protect the local water resources through the development and use of sound operating and fiscal practices in the treatment of municipal wastewater. To meet its mission, the Joint Plant must generate sufficient funds through its bulk (wholesale) treatment rate to meet current operating and maintenance costs and long-term capital requirements. The bulk rate charged tributary governmental units for wastewater treatment service is reviewed annually and adjusted periodically by the Joint Board to meet projected needs. For the fiscal year ended June 30, 2006, the bulk treatment rate was \$1,143 per million gallons. The bulk treatment rate provides in excess of 95 percent of the Joint Plant's total operating revenue. Revenue contributed by the tributary governmental units is a factor of discharged flow and the bulk treatment rate. Other sources of revenue, in order of magnitude, include industrial surcharges (high-strength wastewaters), septic tank waste treatment, and laboratory fees. Revenue from bulk treatment decreased during this fiscal year due to suspected reduced inflow and infiltration of rainwater and groundwater into the collection system. In addition, this was the first full year that Dean Foods Specialty Group, a significant water user, was not discharging into the Benton Harbor collection system. The firm ceased local operations in November 2004.

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Management's Discussion and Analysis (Continued)

Condensed Financial Information

The following table represents condensed information about the Joint Plant's financial position for the past three fiscal years. Total net assets increased by approximately \$1,476,000 between fiscal years 2004-2006. This increase in net assets is also reflected by an increase in current assets. Unrestricted net assets include an amount designated by the board for future construction projects. Investment maturities have been structured to meet these future needs.

	Fiscal Year Ended June 30		
	2006	2005	2004
Assets			
Current assets	\$ 7,539,172	\$ 8,984,539	\$ 8,016,083
Capital assets	<u>14,150,843</u>	<u>9,496,358</u>	<u>9,522,113</u>
Total assets	21,690,015	18,480,897	17,538,196
Liabilities			
Current liabilities	1,864,902	505,199	367,488
Long-term debt	<u>1,178,369</u>	<u>-</u>	<u>-</u>
Total liabilities	<u>3,043,271</u>	<u>505,199</u>	<u>367,488</u>
Net Assets			
Invested in capital assets	12,628,174	9,496,358	9,522,113
Unrestricted	<u>6,018,569</u>	<u>8,479,340</u>	<u>7,648,595</u>
Total net assets	<u>\$ 18,646,743</u>	<u>\$ 17,975,698</u>	<u>\$ 17,170,708</u>

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Management's Discussion and Analysis (Continued)

Operating Income and Expenses

The Joint Plant's financial position at June 30, 2006 is sound. Operating income from the bulk treatment charges combined with nonoperating interest income and revenue from industrial "high-strength" surcharges, laboratory fees, and other miscellaneous income was adequate to meet operating expenses. The largest capital improvement project to date, the Digester Renovation and Chlorination Project, was begun in May 2005. The project, with a construction contract amount of \$8,233,032, is expected to be completed in the fall of fiscal 2007. Project funding will come from reserves and a short-term (five-year) capital equipment lease. Operating income and expense, nonoperating income, and capital improvement expenditures for the past three fiscal years are presented below.

	Fiscal Year Ended June 30		
	2006	2005	2004
Operating revenue:			
Operating income (treatment charges)	\$ 3,171,291	\$ 3,496,057	\$ 3,318,546
Lab, septic, and miscellaneous billings	74,336	67,861	69,573
Total operating revenue	3,245,627	3,563,918	3,388,119
Operating expense:			
Operating and maintenance costs	1,818,404	1,843,213	1,921,538
Depreciation	731,961	758,646	658,019
Administrative and other	269,511	293,570	281,603
Total operating expenses	2,819,876	2,895,429	2,861,160
Nonoperating income (expense):			
Nonoperating income (interest income)	300,218	171,942	89,503
Nonoperating expense (interest expense and loss on disposal)	(54,924)	(35,441)	(6,267)
Total nonoperating income	245,294	136,501	83,236
Net income	<u>\$ 671,045</u>	<u>\$ 804,990</u>	<u>\$ 610,195</u>
Expenditures for capital improvements	<u>\$ 5,389,550</u>	<u>\$ 768,332</u>	<u>\$ 733,778</u>

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Management's Discussion and Analysis (Continued)

As the data indicates, operating income for fiscal 2006 decreased by approximately \$318,000 over the previous fiscal year as a result of lower flows from the tributary governmental units due to suspected reduced inflow and infiltration of rainwater and groundwater into the collection system. Looking forward, operating income is anticipated to rise moderately over the next five years with forecasted increases in the bulk treatment rate. Operating expenses decreased slightly from the previous fiscal year by approximately \$76,000 due to reduced staffing and delayed operating supplies purchasing. Operating expenses are expected to trend upward. The Joint Plant is experiencing increasing difficulty in managing operating costs with rising natural gas and electric rates and increased employee benefit cost - primarily in the area of health insurance premiums and required pension fund contributions. Management recognizes that control over year-to-year operating costs is essential to the long-term financial health of the facility. Efforts to control operating costs are ongoing. A five-year financial plan is employed to forecast revenue, operating and maintenance, and capital improvements costs.

Nonoperating Interest Income

In prior years, nonoperating income has significantly contributed to the Joint Plant's overall revenue base. The rise in interest income this past year is a reflection of more favorable interest rates available in the Joint Plant's investment instruments. Interest rates moved up and are expected to remain stable to higher throughout fiscal year 2007. However, the funding requirements for the Digester Renovation and Chlorination Project will significantly deplete the Joint Plant's investment portfolio over the next several years, which in turn will negatively impact future nonoperating interest income.

Capital Improvements and Funding Requirements

Funding needs for capital improvements are a significant element in the Joint Plant's financial plan. The facility's five-year capital plan calls for the expenditure of \$8,542,000 in facility improvements. Of this amount, approximately \$6,072,000 is currently available to meet capital requirements. The balance of the required funds will be generated through operating revenues and short-term capital equipment leases. For the fiscal year just ended, capital expenditures were primarily related to construction, inspection, and engineering work associated with the Digester Renovation and Chlorination Project.

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Management's Discussion and Analysis (Continued)

Looking beyond the next five years, capital improvements totaling an additional \$13,305,000 have been identified. These proposed projects are listed in the Joint Plant's 10-year Capital Improvement Plan as found in the fiscal 2006 budget. These projected capital needs are a result of the Strategic Capital Improvement Plan (SCIP) prepared for the Joint Plant by Consoer Townsend Envirodyne Engineers. Elements of the SCIP include assessment of the physical condition of the existing plant, a review of projected future service requirements (population, business, and residential growth within the Joint Plant's service area), existing treatment process and hydraulic capacity limitations in the facility, and identification of capital needs over the next 11 years. The SCIP study was completed in fiscal 2004 and provides a roadmap for future capital projects at the Joint Plant.

Fiscal Year 2006 Budget Variances

The 2006 fiscal year ended with actual operating income lower than budgeted income by \$261,000. Operating expenses before depreciation, on the other hand, closed the year under budget by approximately \$380,000. Savings in budgeted labor expense (\$158,524), chemicals (\$26,238), sludge handling (\$10,262), maintenance supplies and contracts (\$46,096), and public utilities (\$79,481) accounted for a majority of this amount. Savings of this magnitude are not anticipated for future budget years. The contract with the Joint Plant's land application contractor will expire in December 2006. The latest supply contract bids for polymer and ferrous chloride resulted in significantly higher unit costs for these materials. The subject contracts extend through December 2006 for polymer and April 2007 for ferrous chloride. Disinfection costs are expected to rise as a result of the plant's conversion from gaseous chlorine and sulfur dioxide to liquid sodium hypochlorite and sodium bisulfite, which are much safer products. While natural gas and electric power costs came in below budget, the cost of these commodities is expected to rise in the coming years. Natural gas costs have risen dramatically and are quite unstable on a monthly basis. The feasibility of purchasing natural gas supply contracts is being evaluated on a continual basis.

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Management's Discussion and Analysis (Continued)

Capital Assets

An appraisal of the Joint Plant's buildings and equipment is conducted annually for property insurance purposes. The appraisal conducted on October 28, 2005 established the insurable replacement value of the plant at \$36,272,412. To protect this investment in physical assets, the Joint Plant has developed and maintains a 10-year capital improvement plan. The capital plan, which is updated annually, is directed toward maintaining, improving, and expanding the facility. Identified capital improvements total \$8,542,000 over the next five years and \$21,847,000 over 10 years. Funding for the proposed improvements is anticipated to come from operating revenue. Long-term bonding is not expected to be employed to fund these improvements. Lease purchase agreements may be utilized to meet short-term, three- to six-year cash flow requirements for these projects. The general condition of the physical assets (buildings and equipment) is considered good, but maintaining the capital improvement schedule as proposed will be critical in protecting the long-term value and reliability of these assets. The Consoer Townsend Envirodyne Engineers has provided an updated Strategic Capital Improvement Plan for the facility. This plan identifies and updates capital needs and their associated costs through fiscal 2016. The study was completed in fiscal 2004.

The Joint Plant has entered into a capital lease agreement with Key Governmental Finance for the purpose of short-term funding for the current improvement project. A total of \$1,800,000 was secured for this purpose with a repayment term of 60 months. Proposals were solicited from several financial institutions and reviewed by the Joint Board prior to entering into the agreement with Key Governmental Finance. A balance of \$1,522,668 is outstanding as of June 30, 2006.

Contacting the Joint Plant's Management

The purpose of this management's discussion and analysis is to provide an overview of the current and prospective financial condition of the Joint Plant's operations and physical assets. Questions concerning this report may be directed to Timothy J. Lynch, plant manager.

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Statement of Net Assets

	June 30	
	2006	2005
Assets		
Cash and cash equivalents (Note 3)	\$ 1,618,393	\$ 1,859,552
Investments (Note 3)	5,417,805	6,549,838
Accounts receivable	285,032	453,652
Accrued interest receivable	126,710	91,254
Prepaid expenses	91,232	30,243
Capital assets - Net (Note 4):		
Assets subject to depreciation	7,561,672	8,164,731
Assets not subject to depreciation	6,589,171	1,331,627
Total assets	21,690,015	18,480,897
Liabilities		
Accounts payable	901,284	355,147
Contracts retainage payable	461,159	-
Accrued wages payable and other liabilities	158,160	150,052
Noncurrent liabilities (Note 5):		
Due within one year - Capital lease	344,299	-
Due in more than one year - Capital lease	1,178,369	-
Total liabilities	3,043,271	505,199
Net Assets		
Invested in capital assets - Net of related debt	12,628,174	9,496,358
Unrestricted (Note 2)	6,018,569	8,479,340
Total net assets	\$ 18,646,743	\$ 17,975,698

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Statement of Revenue, Expenses, and Changes in Net Assets

	Year Ended June 30	
	2006	2005
Operating Revenue		
Sewage treatment charges	\$ 3,171,291	\$ 3,496,057
Laboratory fees	21,106	22,631
Miscellaneous	53,230	45,229
	<u>3,245,627</u>	<u>3,563,917</u>
Total operating revenue		
Operating Expenses		
Operation and maintenance	1,818,404	1,843,210
Depreciation	731,961	758,645
Administrative and other	269,511	293,573
	<u>2,819,876</u>	<u>2,895,428</u>
Total operating expenses		
Operating Income	425,751	668,489
Nonoperating Income (Expense)		
Interest earnings on investments	300,218	171,942
Interest expense	(51,818)	-
Loss on disposal of capital asset	(3,106)	(35,441)
	<u>245,294</u>	<u>136,501</u>
Total nonoperating income		
Net Income	671,045	804,990
Net Assets - Beginning of year	<u>17,975,698</u>	<u>17,170,708</u>
Net Assets - End of year	<u>\$ 18,646,743</u>	<u>\$ 17,975,698</u>

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Statement of Cash Flows

	Year Ended June 30	
	2006	2005
Cash Flows from Operating Activities		
Cash received from customers	\$ 3,414,247	\$ 3,827,832
Cash payments to suppliers for goods and services	(116,407)	(1,219,447)
Cash payments to employees for services	(1,017,093)	(1,040,333)
Net cash provided by operating activities	2,280,747	1,568,052
Cash Flows from Capital and Related Financing Activities		
Payments for acquisition or construction of capital assets	(5,389,550)	(508,332)
Proceeds received for capital debt	1,800,000	-
Principal and interest paid on capital debt	(329,150)	-
Net cash used in capital and related financing activities	(3,918,700)	(508,332)
Cash Flows from Investing Activities		
Proceeds from sale of investments	5,469,072	2,007,441
Payments for purchase of investments	(4,337,039)	(4,085,895)
Interest received on investments	264,761	128,380
Net cash provided by (used in) investing activities	1,396,794	(1,950,074)
Net Increase (Decrease) in Cash and Cash Equivalents	(241,159)	(890,354)
Cash and Cash Equivalents - Beginning of year	1,859,552	2,749,906
Cash and Cash Equivalents - End of year	<u>\$ 1,618,393</u>	<u>\$ 1,859,552</u>
Reconciliation of Operating Income to Net Cash from Operating Activities		
Operating income	\$ 425,751	\$ 668,489
Adjustments to reconcile operating income to net cash from operating activities - Changes in assets and liabilities:		
Depreciation	731,961	758,646
(Increase) decrease in assets:		
Accounts receivable	168,620	263,915
Prepaid expenses	(60,989)	(709)
Increase (decrease) in liabilities:		
Accounts payable	546,137	(110,191)
Accrued wages and other liabilities	469,267	(12,098)
Net cash provided by operating activities	<u>\$ 2,280,747</u>	<u>\$ 1,568,052</u>

Noncash Operating, Capital, and Investing Activities - During the year, there were no noncash activities.

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Notes to Financial Statements June 30, 2006 and 2005

Note 1 - Nature of Entity

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant (the "Joint Plant") is a joint venture of the cities of Benton Harbor and St. Joseph, Michigan and was created pursuant to Public Act 129, Michigan Public Acts of 1943. Its allowed purpose is to acquire and operate a sewage disposal system. The Joint Plant currently operates a sewage transportation and processing system to these communities as well as for surrounding municipalities.

The Internal Revenue Service has ruled that the Joint Plant is a political subdivision of the State of Michigan and, as a result, is exempt from federal income tax.

Note 2 - Summary of Significant Accounting Policies

The accounting policies of the Benton Harbor - St. Joseph Joint Wastewater Treatment Plant conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of significant accounting policies:

Reporting Entity - The accompanying basic financial statements have been prepared in accordance with criteria established by the Governmental Accounting Standards Board for determining the various governmental organizations to be included in a reporting entity. In accordance with these guidelines, there are no component units to be included in the financial statements.

Basis of Accounting - The accrual basis of accounting is used to account for the operations of the Joint Plant. The Joint Plant follows all pronouncements of the Governmental Accounting Standards Board and those of the Financial Accounting Standards Board issued prior to November 30, 1989. The Joint Plant has elected not to follow private sector standards issued after November 30, 1989.

Operating Revenue - Operating revenue represents billings to area municipalities based on flow rates metered by the Joint Plant as well as charges to local businesses for extra strength industrial processing.

Capital Assets - Property, plant, and equipment are stated at cost. Depreciation has been charged as an expense against operations of the Joint Plant on a straight-line basis.

Cash Equivalents - The Joint Board considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. In addition, the statement of cash flows includes both restricted and unrestricted cash and cash equivalents.

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Notes to Financial Statements June 30, 2006 and 2005

Note 2 - Summary of Significant Accounting Policies (Continued)

Investments - Investments are recorded at fair value, based on quoted market prices.

Unrestricted Net Assets - The Joint Plant, through board action, has designated the use of unrestricted net assets as follows:

	2006	2005
Designated for future repairs and replacements	\$ 5,500,000	\$ 5,500,000
Undesignated and unallocated	518,569	2,979,340
Total unrestricted net assets	<u>\$ 6,018,569</u>	<u>\$ 8,479,340</u>

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Note 3 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The Joint Plant has designated one bank for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in all of the above except deposits in credit unions and repurchase agreements. The Joint Plant's deposits and investment policies are in accordance with statutory authority.

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Notes to Financial Statements June 30, 2006 and 2005

Note 3 - Deposits and Investments (Continued)

The Joint Plant's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the Joint Plant's deposits may not be returned to it. The Joint Plant does not have a deposit policy for custodial credit risk. At year end, the Joint Plant had approximately \$6,505,000 of bank deposits (certificates of deposit, checking and savings accounts) that were uninsured and uncollateralized. The Joint Plant believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Joint Plant evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Custodial Credit Risk of Investments - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Joint Plant will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Joint Plant does not have a policy for custodial credit risk. At year end, approximately \$823,000 of investment securities were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the Joint Plant's name.

Interest Rate Risk - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Joint Plant's investment policy does not restrict investment maturities other than commercial paper, which can only be purchased with a 270-day maturity. At year end, the maturities of investments are as follows:

Investment	Fair Value	Investment Maturity	
		Less than 1 Year	1-5 Years
Commercial paper	\$ 823,275	\$ 823,275	\$ -

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Notes to Financial Statements June 30, 2006 and 2005

Note 3 - Deposits and Investments (Continued)

Credit Risk - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Joint Plant has no investment policy that would further limit its investment choices. As of year end, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating Organization
Commercial paper	\$ 823,275	P-I	Moody's

Note 4 - Capital Assets

Capital asset activity for the year ended June 30, 2006 was as follows:

	2005	Additions	Disposals	Transfers	2006	Depreciable Life - Years
Land	\$ 24,161	\$ -	\$ -	\$ -	\$ 24,161	-
Land improvements	104,032	-	-	-	104,032	10-25
Buildings	12,835,734	-	(16,361)	65,181	12,884,554	25-50
Equipment	6,818,040	66,825	(35,292)	-	6,849,573	3-25
Construction in progress	1,307,466	5,322,725	-	(65,181)	6,565,010	-
Total	21,089,433	5,389,550	(51,653)	-	26,427,330	
Less accumulated depreciation	(11,593,075)	(731,961)	48,548	-	(12,276,488)	
Net carrying amount	<u>\$ 9,496,358</u>	<u>\$ 4,657,589</u>	<u>\$ (3,105)</u>	<u>\$ -</u>	<u>\$ 14,150,842</u>	

The Joint Plant had commitments as of June 30, 2006 as follows:

	Spent to Date	Remaining Commitment
WWTP 2004 improvements	\$ 4,755,000	\$ 3,520,000
Influent pumping project	20,000	106,000
Miscellaneous	-	6,100

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Notes to Financial Statements June 30, 2006 and 2005

Note 5 - Long-term Debt

The Joint Plant has entered into a lease agreement as lessee for the purpose of financing the completion of the Digester Renovation and Chlorination Project. A summary of debt outstanding of the Joint Plant at June 30, 2006 is as follows:

	Interest Rate	Principal Maturity Date	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due within One Year
Capital lease payable	3.710	8/30/2010	\$ -	\$ 1,800,000	\$ (277,332)	\$ 1,522,668	\$ 344,299
Amount of issue: \$1,800,000							

Debt Service Requirements

The annual requirements to service all debt outstanding as of June 30, 2006, including both principal and interest, are as follows:

Years Ending June 30	Amount
2007	\$ 394,980
2008	394,980
2009	394,980
2010	394,980
2011	65,830
Total	<u>\$ 1,645,750</u>

Interest

Interest expense of the Joint Plant for the year ended June 30, 2006 approximated \$52,000.

Note 6 - Defined Benefit Pension Plan

Plan Description - The Benton Harbor - St. Joseph Joint Wastewater Treatment Plant contributes to the City of St. Joseph Employees' Retirement System, a multi-employer defined benefit pension plan administered by the City of St. Joseph. The plan provides retirement, disability, and death benefits to plan members and their beneficiaries. The plan issues a publicly available financial report that is included in the basic financial statements of the City of St. Joseph. That report may be obtained by writing to the City of St. Joseph, Broad Street, St. Joseph, Michigan.

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Notes to Financial Statements June 30, 2006 and 2005

Note 6 - Defined Benefit Pension Plan (Continued)

The obligation to contribute to and maintain the system for these employees was established by a resolution of the Joint Plant's board of directors and requires a contribution from the employees of 4 percent of gross wages. The Joint Plant is required to contribute at actuarially required rates resulting in a contribution of \$6,728 and \$0 for the years ended June 30, 2006 and 2005, respectively. The contribution for the year ending June 30, 2007 is projected at 9.97 percent of payroll.

Note 7 - Other Postemployment Benefits

The Joint Plant has elected to provide postemployment health benefits to certain retirees. The Joint Plant pays 50 percent of the cost of medical premiums for all retired management employees until the age of 65. The Joint Plant also pays 50 percent of the medical premiums for all union employees for up to 24 months from the eligibility date of retirement. Currently, four retirees are receiving postemployment health benefits. For the fiscal year ended June 30, 2006, the Joint Plant made payments for postemployment health benefit premiums of \$18,374. The Joint Plant obtains health care coverage through private insurers.

Upcoming Reporting Change - The Governmental Accounting Standards Board has recently released Statement No. 45, *Accounting and Reporting by Employers for Postemployment Benefits Other than Pensions*. The new pronouncement provides guidance for governmental entities in recognizing the cost of retiree health care, as well as any "other" postemployment benefits (other than pensions). The new rules will cause the government-wide financial statements to recognize the cost of providing retiree health care coverage over the working life of the employee, rather than at the time the health care premiums are paid. The new pronouncement is effective for the year ending June 30, 2010.

Note 8 - Risk Management

The Joint Plant is exposed to various risks of loss related to property loss, torts, errors and omissions, unemployment claims, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The Joint Plant participates in the following risk management plans sponsored by the Michigan Municipal League to minimize its exposure to loss in these areas:

- Michigan Municipal Liability and Property Pool - Property, general liability, errors and omissions, and automotive coverage
- Municipal Unemployment Compensation Group Account
- Michigan Municipal Workers' Compensation Fund

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Notes to Financial Statements June 30, 2006 and 2005

Note 8 - Risk Management (Continued)

- Michigan Municipal League Cluster for Employee Medical Benefits - Blue Cross/Blue Shield and vision coverage

The Joint Plant has also purchased commercial insurance coverage for dental benefits (all employees) and short-term disability benefits for unionized employees.

The Michigan Municipal League operates/administers the referenced risks management plans for local units of government in Michigan; members' premiums are used to support the risk pools and underlying coverage, to purchase commercial excess insurance coverage, and to pay claims in excess of deductible amounts.

Settled claims relating to the various risk pools or commercial insurance have not exceeded the amount of insurance coverage in any of the past three years.

Supplemental Information

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Schedule of Treatment Charges - Budget and Actual Year Ended June 30, 2006

	Original and Amended Budget	Actual	Variance Favorable (Unfavorable)
Benton Harbor Billings:			
City of Benton Harbor	\$ 594,000	\$ 591,652	\$ (2,348)
Benton Charter Township	1,023,000	864,008	(158,992)
St. Joseph Charter Township	107,000	102,293	(4,707)
Total Benton Harbor billings	1,724,000	1,557,953	(166,047)
St. Joseph Billings:			
City of St. Joseph	754,000	678,985	(75,015)
Lake Michigan Shoreline Authority	924,000	877,268	(46,732)
Total St. Joseph billings	1,678,000	1,556,253	(121,747)
Industrial surcharge	30,000	57,085	27,085
Total sewage treatment charges	<u>\$ 3,432,000</u>	<u>\$ 3,171,291</u>	<u>\$ (260,709)</u>

Benton Harbor - St. Joseph Joint Wastewater Treatment Plant

Schedule of Operating Expenses - Budget and Actual Year Ended June 30, 2006

	Original and Amended Budget	Actual	Variance Favorable (Unfavorable)
Operation and Maintenance			
Payroll expenses	\$ 1,183,725	\$ 1,025,201	\$ 158,524
Operating supplies	97,700	71,462	26,238
Repair and maintenance supplies	28,700	15,754	12,946
Sludge handling	245,000	234,738	10,262
Transportation	9,900	8,326	1,574
Repair and maintenance contracts	94,500	48,404	46,096
Public utilities	494,000	414,519	79,481
Total operation and maintenance	<u><u>\$ 2,153,525</u></u>	<u><u>\$ 1,818,404</u></u>	<u><u>\$ 335,121</u></u>
Administrative and Other			
Professional services	\$ 53,500	\$ 27,346	\$ 26,154
Office supplies	6,500	4,407	2,093
Printing and publishing	700	140	560
Insurance and bonds	49,000	47,210	1,790
Billing charges	170,000	155,710	14,290
Miscellaneous	35,000	34,698	302
Total administrative and other	<u><u>\$ 314,700</u></u>	<u><u>\$ 269,511</u></u>	<u><u>\$ 45,189</u></u>

To the Joint Board of Commissioners
Benton Harbor - St. Joseph Joint
Wastewater Treatment Plant

In connection with the audit of the financial statements of the Benton Harbor - St. Joseph Wastewater Plant (the "Plant") for the year ended June 30, 2006, we offer the following comments and recommendations.

Financial Overview

During the year ended June 30, 2006, the Plant's overall financial condition remained stable with net income of approximately \$671,000. Total assets increased approximately \$3,209,000. This increase is reflected mostly in the balance of construction in progress, which increased approximately \$5,300,000. Net assets increased to approximately \$18.6 million. Of this net asset amount, \$5.5 million is board designated for future replacement of plant and equipment, \$12.6 million represents the investment in plant and equipment, leaving approximately \$519,000 of undesignated net assets. Actual sewage treatment charges were approximately \$325,000 less than budgeted revenue. Total operating revenue decreased by approximately \$318,000, which is a decrease of 8.9 percent. This is the result of lower flows from the tributary governmental units due to suspected reduced inflow and infiltration of rainwater and groundwater into the collection system. Operating expenses (excluding depreciation expense) decreased by approximately \$49,000, which is a decrease of 2.3 percent and were approximately \$380,000 less than budget. Overall, this generated a favorable variance of approximately \$120,000.

Controls Over Manual Journal Entries

We would like to commend the board on reviewing all manual journal entries in conjunction with each monthly board meeting. This allows for improved control over the Plant's general ledger.

Retiree Health Care Benefits

The Governmental Accounting Standards Board has recently released Statement Number No. 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree health care, as well as any "other" postemployment benefits (other than pensions). The intent of the new rules is to recognize the cost of providing retiree health care coverage over the working life of the employee, rather than at the time the health care premiums are paid. These new rules will apply to the government-wide financial statements, rather than the individual fund level. Therefore, the manner in which retiree health care benefits are budgeted will not change, unless you begin funding the benefits (however, as discussed below, there are incentives to do so).

To the Joint Board of Commissioners
Benton Harbor - St. Joseph Joint
Wastewater Treatment Plant

The new pronouncement will require a valuation of the obligation to provide retiree health care benefits, including an amortization of the past service cost over a period of up to 30 years. The valuation must include an annual recommended contribution (ARC). While the ARC does not need to be funded each year, any under-funding must be reported as a liability on the government-wide statement of net assets.

This valuation will need to be performed by an actuary if the total participants exceed 100. Participants are defined as employees in active service, terminated employees not yet receiving benefits, plus retirees and beneficiaries currently receiving benefits. For plans with 100 to 200 participants, the actuarial valuation must be at least every three years; for those over 200 participants, at least every other year.

This statement is being phased in over a three-year period, similar to GASB 34. It is effective for fiscal years beginning after December 15, 2006, 2007, or 2008, depending on whether your revenues are over \$100 million, between \$10 million and \$100 million, or under \$10 million. Remember that planning to make the annual recommended contribution generally requires up to three to six months for an actuarial valuation plus six months lead time to work the numbers into the budget. Therefore, we recommend that you begin the actuarial valuation at least one year prior to the above dates.

The GASB statement has provided substantial incentive to fund the obligation in accordance with the annual recommended contribution. In addition to the normal fairness issue of paying for a service as you use it, the GASB has directed that lower rates of return be used for evaluating the annual recommended contribution in situations where the recommended contribution is not being funded. This will significantly increase the calculation of the following year's contribution. Therefore, funding the contribution will actually reduce your long-run cost.

Investment Policy Testing

During the audit, we reviewed the investment policy requirements of the Plant and it appears that the Plant is following this policy. We did not note any exceptions during our testing of June 30, 2006 balances. We would like to compliment the board on the excellent condition of the investment records and the positive condition of the investment portfolio. Based on our review, it appears that the portfolio is appropriately diversified, in order to comply with the policy. It also appears that all required procedures are in place and being followed by the plant manager as directed by the board.

To the Joint Board of Commissioners
Benton Harbor - St. Joseph Joint
Wastewater Treatment Plant

Accounting Record and Controls

We would like to compliment the Joint Board of Commissioners and plant management for your sound and responsible financial leadership. This is evident in the overall positive condition of the Plant's financial records and related documentation for the fiscal year ended June 30, 2006. The Plant continues to maintain strong internal control procedures over cash collections, payroll, and cash disbursement functions. In addition, the appropriate authorization channels and checks and balances necessary for a sound internal control system are in place at the Plant and operating effectively. Strong internal controls and procedures promote timely and accurate recording of financial transactions and provide pertinent information regarding the sources and uses of public funds. We encourage the Plant to continue to modify and refine existing control procedures as future financial activities change.

We would be happy to discuss these comments with you at any time. We appreciate the courtesy extended to us during the audit.

Plante & Moreau, PLLC

August 1, 2006